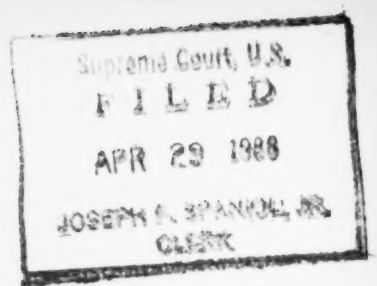


87-1791

(1)



No.

IN THE SUPREME COURT OF THE UNITED STATES

October Term, 1988

NORTHWESTERN NATIONAL INSURANCE COMPANY
OF MILWAUKEE, WISCONSIN,

Petitioner,

vs.

MELLON BANK, N.A.,

Respondent.

PETITION FOR WRIT OF CERTIORARI

To the United States Court of Appeals

For the Third Circuit

JOHN J. HARRIGAN, Counsel of Record
ROBERT D. KEHOE
WILLIAM H. BAUGHMAN, JR.
WESTON, HURD, FALLON,
PAISLEY & HOWLEY
2500 Terminal Tower
Cleveland, Ohio 44113-2241
216/241-6602

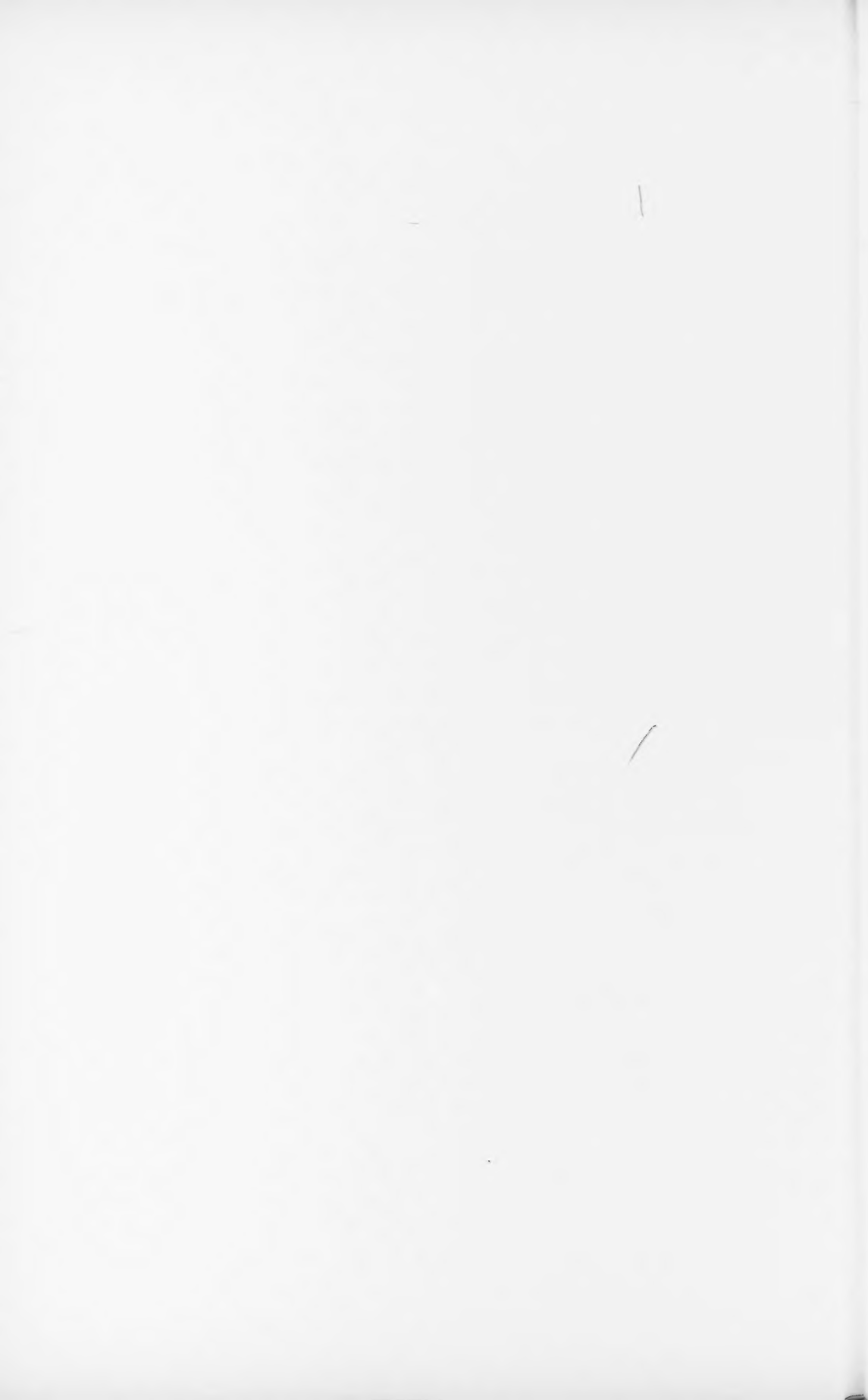
Counsel for Petitioner

April 29, 1988

6177

QUESTIONS PRESENTED

1. DOES THE AUTOMATIC STAY ARISING PURSUANT TO 28 U.S.C. 362 BAR SUIT BY A CREDITOR OF A DEBTOR AGAINST A THIRD PARTY WHERE THE DEBTOR HAS A CONTRACTUAL OBLIGATION TO INDEMNIFY THE THIRD PARTY AGAINST ANY JUDGMENT RECEIVED BY THE CREDITOR? THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT HELD THAT IT DID NOT. THIS DECISION DIRECTLY CONFLICTS WITH THE DECISION OF THE UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT IN A.H. ROBINS CO., INC. V. PICCININ, 788 F.2D 994 (4TH CIR. 1986).
2. MAY A FEDERAL DISTRICT COURT RULE ON THE MERITS OF CLAIMS ASSERTED BY PARTIES OUTSIDE THE PERSONAL JURISDICTION OF THAT COURT IN ANOTHER JUDICIAL DISTRICT, SUCH CLAIMS, IF MERITORIOUS, CONSTITUTING ABSOLUTE DEFENSES TO CLAIMS PENDING BEFORE THAT COURT?



No.

IN THE SUPREME COURT OF THE UNITED STATES

October Term, 1988

NORTHWESTERN NATIONAL INSURANCE COMPANY
OF MILWAUKEE, WISCONSIN,

Petitioner,

vs.

MELLON BANK, N.A.,

Respondent.

DISCLOSURE OF CORPORATE AFFILIATIONS

Pursuant to Supreme Court Rule 28.1, petitioner Northwestern National Insurance Company of Milwaukee, Wisconsin makes the following disclosure:

The petitioner is a subsidiary or affiliate of the following publicly owned corporation:

Northwestern National Insurance Company is a subsidiary of Armco Financial Service Group, which is a subsidiary of Armco, Inc., a publicly owned corporation.

The petitioner has no subsidiaries.



TABLE OF CONTENTS

QUESTIONS PRESENTED	i
PETITION FOR WRIT OF CERTIORARI	1
PRAYER	1
OPINIONS BELOW	2
JURISDICTION	4
STATUTORY PROVISIONS INVOLVED	4
STATEMENT OF THE CASE	7
A. <u>Statement of the Facts</u>	7
B. <u>District Court Proceeding</u>	12
C. <u>Court of Appeals Proceedings</u>	16
<u>WHY THE WRIT SHOULD BE GRANTED</u>	17
1. THE CIRCUIT COURT HELD THAT THE AUTOMATIC STAY CREATED BY 11 U.S.C. §362 DOES NOT EXTEND TO A CONTRAC- TUAL INDEMNITEE OF A DEBTOR IN REORGANIZATION, A HOLDING IN DIRECT CONFLICT WITH THE DECISION OF THE UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT IN <u>A.H. ROBINS</u> <u>V. PICCININ</u> , 788 F.2D 994 (4TH CIR. 1986)	18
2. THIS CASE PRESENTS AN IMPORTANT QUESTION REGARDING THE PROPRIETY OF A DISTRICT COURT RULING ON THE MERITS OF CLAIMS ASSERTED BY PARTIES NOT WITHIN ITS PERSONAL JURISDICTION IN AN ACTION PENDING IN ANOTHER JUDICIAL DISTRICT, WHICH	

CLAIMS CONSTITUTE DEFENSES TO A CAUSE OF ACTION PENDING BEFORE THE DISTRICT COURT	22
---	----

CONCLUSION	28
----------------------	----

TABLE OF AUTHORITIES

Cases

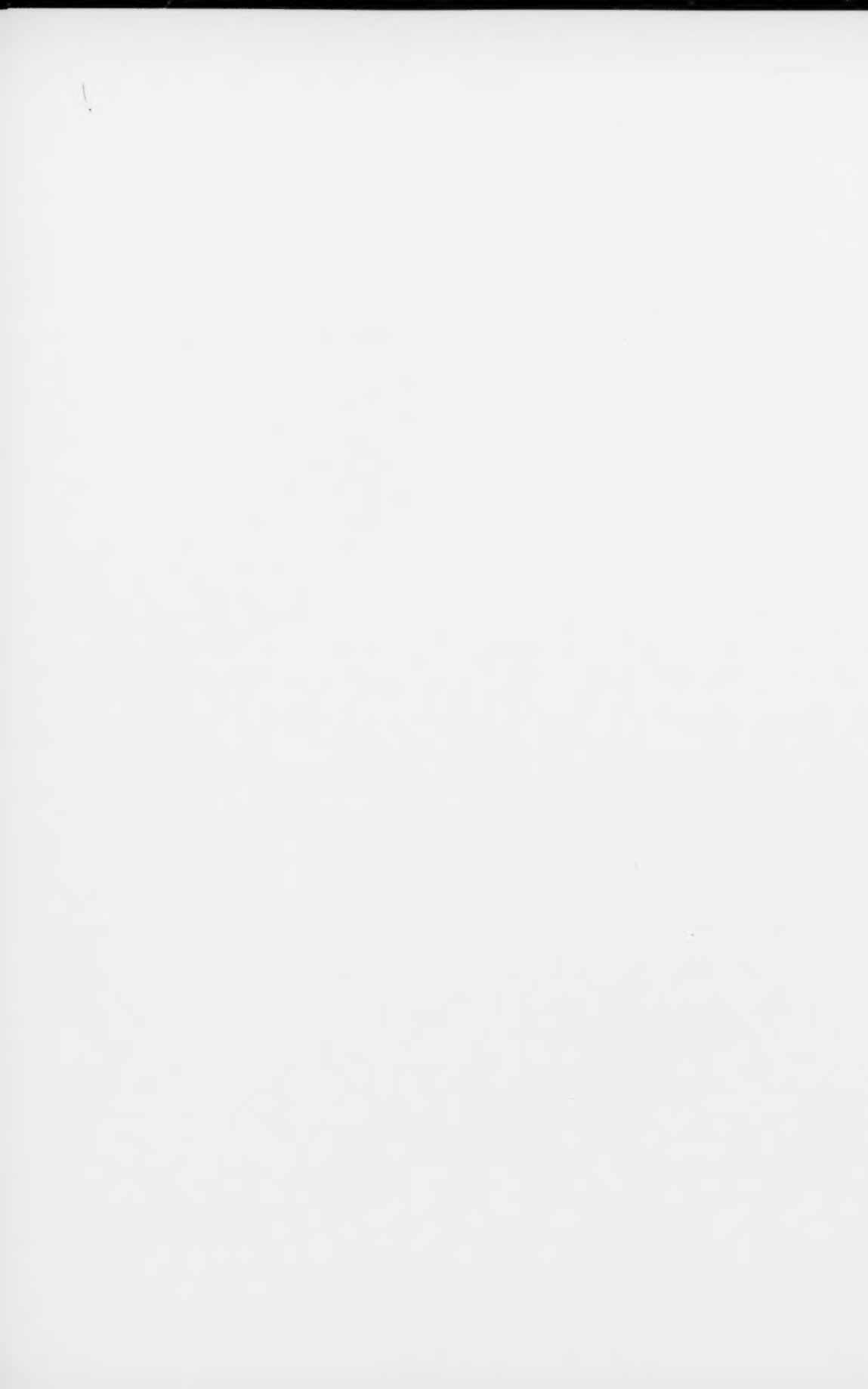
<u>A.H. Robins Co., Inc.</u> <u>v. Piccinin</u> , 788 F.2d 994 (4th Cir. 1986)	14, 18, 20, 21
<u>Chamber Development Co., Inc.</u> <u>v. Browning-Ferris Industries</u> , 590 F. Supp. 1528, 1539 (W.D. Pa. 1984) 7.	25
<u>Ettlinger v. National Surety Co.</u> , 221 N.Y. 467, 117 N.E. 945-46 (1917) . .	23
<u>Freedman v. Beneficial Corp.</u> , 406 F. Supp. 917, 925 (D. Del. 1975) . .	25
<u>Johns-Manville Sales Corp.</u> , 26 B.R. 405, 410 (S.D. N.Y. 1983) . . .	19
<u>McClendon v. Continental Group, Inc.</u> , 602 F. Supp. 1492, 1509 (D. N.J. 1985)	25
<u>Rhode Island Hospital Trust National Bank</u> <u>v. Ohio Casualty Ins. Co.</u> , 789 F.2d 74, 78-80 (1st Cir. 1986) . . .	22
<u>Roger v. Lehman Bros. Kuhn Loeb, Inc.</u> , 604 F. Supp. 222, 225-26 (S.D. Ohio 1984)	25
<u>Royal Trucks & Trailer</u> <u>v. Armadors Meritina Salvadoreana</u> , 10 B.R. 488, 491 (N.D. Ill. 1981) . . .	19
<u>United States v. Griffin</u> , 707 F.2d 1477, 1481 (D.C. Cir. 1983) . .	23

Statutes

11 U.S.C. §362	2, 14, 17, 18, 21
11 U.S.C. §362(a)	4
11 U.S.C. §362(a)(1)	19
11 U.S.C. §362(d)	4
15 U.S.C. 78eee(a)(3)	4
28 U.S.C. §1254(1)	4
28 U.S.C. §1332	7
28 U.S.C. §1404(a)	13
28 U.S.C. §2101(c)	4

Other

Federal Rule of Civil Procedure 9(b)	16, 24, 25
Federal Rule of Civil Procedure 15	24
Restatement of Security §118 (1941)	22
Supreme Court Rule 20.4	4
5 Wright & Miller, <u>Federal Practice & Procedure (Civil)</u> §1300, at 417 (1969)	24



No.

IN THE SUPREME COURT OF THE UNITED STATES

October Term, 1988

NORTHWESTERN NATIONAL INSURANCE COMPANY
OF MILWAUKEE, WISCONSIN,

Petitioner,

vs.

MELLON BANK, N.A.,

Respondent.

PETITION FOR WRIT OF CERTIORARI

To the United States Court of Appeals
For the Third Circuit

Petitioner, Northwestern National Insurance Company of Milwaukee, Wisconsin ("NNIC"), respectfully prays that a writ of certiorari issue to review the judgment and decision of the United States Court of Appeals for the Third Circuit filed in these proceedings on January 28, 1988.

OPINIONS BELOW

This petition seeks review of a judgment order of the United States Court of Appeals for the Third Circuit that conflicts with a decision of the United States Court of Appeals for the Fourth Circuit on the issue of the applicability of the automatic stay provided by 11 U.S.C. §362 to a party that a debtor in reorganization has a contractual duty to indemnify. The petition also seeks review of the circuit court's affirmance of the district court's decision ruling on the merits of claims pending in another federal district, which, if valid, would constitute a defense to the claims pending before the district court.

The judgment order of the United States Court of Appeals for the Third Circuit in Case No. 87-3563 is reported in the table at 838 F.2d 1207 and is reproduced in the Appendix at pages A1 to A2. The circuit court decided the case without a published

opinion.

The orders and memoranda of the United States District Court for the Western District of Pennsylvania are also unreported and are reproduced in the Appendix at pages A3 to A24.

JURISDICTION

The judgment entry of the United States Court of Appeals for the Third Circuit was entered on January 28, 1988. Petitioner filed a timely Petition for Rehearing and Suggestion for Rehearing En Banc. The Petition for Rehearing and Suggestion for Rehearing En Banc was denied on March 2, 1988. The petition is timely filed within the time period provided by 28 U.S.C. §2101(c) and Supreme Court Rule 20.4. This Court's jurisdiction is invoked under 28 U.S.C. §1254(1).

STATUTORY PROVISIONS INVOLVED

11 U.S.C. §§362(a) and 362(d):

§362. Automatic stay.

(a) Except as provided in subsection (b) of this section, a petition filed under section 301, 302, or 303 of this title, or an application filed under section 5(a)(3) of the Securities Investor Protection Act of 1970 (15 U.S.C. 78eee(a)(3)), operates as a stay, applicable to all entities, of-

(1) the commencement or continuation, including the

issuance or employment of process, of a judicial, administrative, or other proceeding against the debtor that was or could have been commenced before the commencement of the case under this title, or to recover a claim against the debtor that arose before the commencement of the case under this title;

(2) the enforcement, against the debtor or against property of the estate, of a judgment obtained before the commencement of the case under this title;

(3) any act to obtain possession of property of the estate or of property from the estate or to exercise control over property of the estate;

(4) any act to create, perfect, or enforce any lien against property of the estate;

(5) any act to create, perfect, or enforce against property of the debtor any lien to the extent that such lien secures a claim that arose before the commencement of the case under this title;

(6) any act to collect, assess, or recover a claim against the debtor that arose before the commencement of the case under this title;

(7) the setoff of any debt owing to the debtor that arose before

the commencement of the case under this title against any claim against the debtor; and

(8) the commencement or continuation of a proceeding before the United States Tax Court concerning the debtor.

* * *

(d) On request of a party in interest and after notice and a hearing, the court shall grant relief from the stay provided under subsection (a) of this section, such as by terminating, annulling, modifying, or conditioning such stay--

(1) for cause, including the lack of adequate protection of an interest in property under subsection (a) of this section of such party in interest; or

(2) with respect to a stay of an act against property, if--

(A) the debtor does not have an equity in such property; and

(B) such property is not necessary to an effective reorganization.

STATEMENT OF THE CASE

A. Statement of the Facts.

Respondent Mellon Bank, N.A. ("Mellon") brought this diversity action pursuant to 28 U.S.C. §1332 to obtain payment on a financial guarantee bond ("Bond") on which it is creditor and petitioner NNIC is surety. The principals on the Bond are shareholders of Bates Energy Associates, Inc. ("Bates").

As part of a complex arrangement to finance an energy generation project undertaken by Bates in Maine, Bates borrowed \$2,760,000.00 from Mellon and gave a promissory note ("Note"). As a condition to the extension of the loan, Mellon obtained primary security from the shareholders of Bates in the form of limited guaranty and suretyship agreements ("Limited Agreements"). Pursuant to the terms of these Limited Agreements, the shareholders would become primarily obligated on their guarantees without notice or demand if Bates

defaulted on the Note.

As additional security for their guarantees of Bates' obligation of the Note, Mellon required the Bates shareholders to execute, as principals, a financial guarantee bond. NNIC executed the Bond as surety. The event of default triggering the requirement to make payment on the Bond is the default of Bates on the Note. This default provision is consistent with the Limited Agreements executed by the Bates shareholders, wherein the shareholders would become obligated to Mellon on their guarantees upon the default of Bates without any requirement of notice or demand. The face of the Bond, however, clearly identifies the Bates shareholders, not Bates, as the Bond's principals.

For its part, NNIC obtained protection as surety on the Bond by having both the Bates shareholders and Bates execute indemnification agreements. These agreements guaran-

teed that NNIC would receive reimbursement for any payments made as surety on the Bond. The Bates indemnification agreement expressly states that NNIC is guaranteeing the obligations of the shareholders of Bates.

Execution of the Bond, the Limited Agreements and the Note took place in 1983. In 1985, Bates and Mellon agreed to a loan of additional funds and a restructuring of Bates' then current debt. As this agreement would materially alter the obligations of the Bates shareholders on their Limited Agreements and the obligations of the Bates shareholders and NNIC on the Bond, negotiations to amend these contracts ensued. As part of these negotiations, NNIC sought and obtained Mellon's written acknowledgment that the original Bond, and any endorsement amending it, bonded the obligations of the principals only, not the obligations of Bates. In a letter sent by Louis Bouchet, Jr., Assistant Vice President of Mellon, to

NNIC prior to the execution of Endorsement
No. 3 amending the Bond, Mr. Bouchet
unequivocally stated:

This is an acknowledgment of our mutual understanding that you will perform fully all of your obligations to Mellon Bank, N.A. under your bond #XIB 0945005 and all endorsements thereto but that neither such bond nor such endorsements shall be construed to mean that Northwestern is in any manner bonding the obligations of Bates Energy Associates, Inc. to us. Our understanding is that Northwestern National Insurance Company is only bonding the obligations of the several Principals (as defined in the bond).

In reliance upon Mellon's written agreement that NNIC, as surety, was not bonding Bates, NNIC executed the endorsement amending the Bond. At issue in this case is the Bond as amended by Endorsement No. 3.

In late 1985 and in early 1986 Bates defaulted on the Note by failing to make payments thereon and filed for reorganization under Chapter 11 of the Bankruptcy Code. Although Mellon had given notice of default on individual payments as required by the Bond before Bates filed for reor-

ganization, it had not elected to accelerate the debt on the Note as of that time. Mellon chose not to pursue the Bates shareholders on the Limited Agreements on the Bond, but rather to make demand upon NNIC as the Bond's surety. NNIC in turn made demand upon the shareholders to pay Mellon. Receiving no affirmative responses from the shareholders, NNIC made payments under the Bond representing the shareholders' obligations with respect to Note payments then past due only. NNIC, however, refused to recognize Mellon's claim that it had effectively made a post-petition acceleration on the debt on the Note and the obligations on the Limited Agreements and the Bond.

NNIC commenced suit in the United States District Court for the Northern District of Ohio ("Ohio action") [Northwestern National Insurance Company of Milwaukee, Wisconsin v. Barney, et al., Case No. C86-3936] against

the Bates shareholders for reimbursement of the payments made to Mellon under the Bond. In response to that suit, the Bates shareholders filed a third party complaint that, in part, joins Mellon and seeks to have the Limited Agreements and Bond voided because of federal and state securities law violations and common law fraud perpetuated by Mellon and others. This third party complaint gave NNIC its first notice of the fraud defenses to payment claimed by the shareholders.

B. District Court Proceeding.

Shortly after NNIC filed the Ohio action, Mellon brought suit in the United States District Court for the Western District of Pennsylvania ("Pittsburgh action") [Mellon Bank, N.A. v. Northwestern National Insurance Company of Milwaukee, Wisconsin, Case No. 86-2033] seeking judgment on the Bond in the amount of the accelerated indebtedness on the Note. Mellon has never

sought or obtained relief from the automatic stay in effect by virtue of Bates' reorganization, despite Bates' contractual duty to indemnify NNIC on the very claims asserted in the Pittsburgh action.

NNIC made a motion in the Pittsburgh action, pursuant to 28 U.S.C. §1404(a), for a transfer of venue to the Northern District of Ohio. NNIC moved for the transfer because the court in the Pittsburgh action could not obtain jurisdiction over the Bates shareholders, for the convenience of the witnesses and the parties, and to avoid inconsistent judgments. The district court denied the motion, however.

The parties in the Pittsburgh action then cross-moved for summary judgment. Additionally, NNIC reasserted its motion to change venue, arguing that all claims relating to the Bond, including the Bates shareholders' claims that Mellon's fraud voided their obligations thereunder, should be tried in a

single forum having personal jurisdiction over the Bond's creditor (Mellon), its principals (the Bates shareholders), and its surety (NNIC).

In opposing Mellon's motion for summary judgment, NNIC made two principal arguments. First, NNIC maintained that the automatic stay arising pursuant to 11 U.S.C. §362 upon the filing of Bates' petition for reorganization barred Mellon from seeking payment from NNIC on the Bond because the debtor, Bates, had a contractual obligation to indemnify NNIC for such payments. Mellon has never sought relief from the automatic stay. In so arguing, NNIC relied upon the decision of the United States Court of Appeals for the Fourth Circuit in A.H. Robins Co., Inc. v. Piccinin, 788 F.2d 994 (4th Cir. 1986), which extended the protection of the automatic stay to third-parties whom a debtor has a contractual obligation to indemnify.

Second, NNIC argued that the fraud claims of the Bond's principals pending in the Ohio action constitute absolute defenses to the surety's obligation on the Bond and that those claims present genuine issues of material fact that preclude summary judgment.

The district court granted Mellon's motion for summary judgment and denied both NNIC's cross-motion and its reasserted motion to transfer venue. Incredibly, despite the fact that Bates is not the principal on the Bond, the court held that NNIC guaranteed the obligations of Bates on the Note, and, therefore, the fraud defenses of the Bates shareholders did not effect NNIC's liability on the Bond.

NNIC moved to amend or alter judgment. With that motion it placed before the Court an affidavit and the letter of Mellon's Assistant Vice-President, Louis Bouchet, Jr., acknowledging that NNIC was bonding the

obligations of the Bates shareholders and not those of Bates. The affidavit, executed by an officer of NNIC, established that NNIC amended the Bond in reliance upon that letter.

Nevertheless, the district court denied the motion to amend or alter. It acknowledged the Bouchet letter and its potential impact upon NNIC's liability on the Bond. The court chose to brush aside the principals' fraud claims, pending in the Ohio action, because they supposedly lacked the particularity required by Federal Rule of Civil Procedure 9(b). In other words, the Pittsburgh court usurped the prerogative of the Ohio court by passing on the merits of claims of parties not even within its personal jurisdiction.

C. Court of Appeals Proceedings.

NNIC timely appealed to the United States Court of Appeals for the Third Circuit. On appeal NNIC argued that Mellon could not sue

it, a contractual indemnitee of a reorganization debtor, on the Bond without relief from the automatic stay. NNIC further argued that the fraud claims pending in the Ohio action presented genuine issues on material fact going to the issue of NNIC's liability to Mellon on the Bond that precluded summary judgment. Finally, NNIC maintained that the district court should have transferred the action to the Northern District of Ohio so that a court with jurisdiction over all claims and all parties could adjudicate all issues relating to the Bond, thereby avoiding inconsistent judgments. After hearing oral argument, the circuit court affirmed by judgment order without opinion.

WHY THE WRIT SHOULD BE GRANTED

1. THE CIRCUIT COURT HELD THAT THE AUTOMATIC STAY CREATED BY 11 U.S.C. §362 DOES NOT EXTEND TO A CONTRACTUAL INDEMNITEE OF A DEBTOR IN REORGANIZATION, A HOLDING IN DIRECT CONFLICT WITH THE DECISION OF THE UNITED STATES COURT OF APPEALS FOR THE FOURTH

CIRCUIT IN A.H. ROBINS V. PICCININ,
788 F.2D 994 (4TH CIR. 1986).

Bates executed a corporate indemnity agreement obligating it to indemnify NNIC for any payments made to Mellon on the Bond. Prior to the commencement of the Pittsburgh action, Bates filed a petition for reorganization in the United States Bankruptcy Court for the Northern District of Ohio. Despite Bates' "pass-through" liability on the Bond, Mellon did not seek or obtain relief from the automatic stay in effect upon Bates' filing of the petition for reorganization before pursuing its claim against the debtor's indemnitee, NNIC.

In A.H. Robins Co., Inc. v. Piccinin, 788 F.2d 994 (4th Cir. 1986), the Fourth Circuit exhaustively considered whether the automatic stay of 11 U.S.C. §362 extends to a nondebtor sued on a claim that a debtor has a contractual obligation to indemnify. The Court concluded that the stay prevents suit on the indemnified claim, even though a

third party, not the debtor, is the defendant.

However, as the Court in Johns-Manville Sales Corp., 26 B.R. 405, 410 (S.D. N.Y. 1983) remarked, in discussing the oft-cited case, Royal Trucks & Trailer v. Armadors Meritina Salvadoreana, 10 B.R. 488, 491 (N.D. Ill. 1981), "there are cases [under 362(a)(1)] where a bankruptcy court may properly stay the proceedings against non-bankrupt co-defendants" but, it adds, that in order for relief for such non-bankrupt defendants to be available under (a)(1), there must be "unusual circumstances" and certainly "[s]omething more than the mere fact that one of the parties to the lawsuit has filed a Chapter 11 bankruptcy must be shown in order that proceedings be stayed against non-bankrupt parties." This "unusual situation," it would seem, arises when there is such identity between the debtor and the third-party defendant that the debtor may be said to be the real party defendant and that a judgment against the third-party defendant will in effect be a judgment or finding against the debtor. An illustration of such a situation would be a suit against a third-party who is entitled to absolute indemnity by the debtor on account of any judgment that might result against them in the case. To refuse application of the statutory stay in that case would defeat the very purpose and intent of the statute. 788 F.2d at 999 (emphasis added).

Mellon has never challenged either the

validity or the scope of the corporate indemnity agreement between Bates and NNIC.

In the words of the A.H. Robins court, Bates is a "real party defendant" in this case. 778 F.2d at 999. Permitting Mellon to prosecute this action against NNIC, given the identity of its interest with the debtor Bates, has frustrated the legislative intent underpinning the automatic stay. Mellon has done indirectly that which the Bankruptcy Code prohibits it from doing directly--bring suit on an obligation of Bates outside the reorganization proceeding.

Through the relief from stay procedure the bankruptcy court, with a view toward the interest of all concerned parties, makes a considered judgment as to whether a particular claim may be pressed outside the reorganization. These procedures insure that one court with a global view orchestrates the orderly process by which the debtor's obligations are identified,

liquidated, and satisfied.

Application of the A.H. Robins holding here will not necessarily mean that NNIC, the indemnitee, will enjoy absolute protection from Mellon's claim on the Bond. Rather it insured that if Mellon proceeds outside the reorganization, it will do so only after the bankruptcy court has assessed the impact of such litigation on the reorganization effort through the relief from stay procedure. Requiring Mellon to seek relief from the automatic stay will implement the purpose and intent of 11 U.S.C. §362.

By virtue of the circuit court's decision in this case, contractual indemnitees of debtors in reorganization or bankruptcy either gain or lose the protection of the automatic stay depending upon where the creditors on the indemnified debt happen to initiate suit. This Court should grant the writ requested in order to review this

important question and to make uniform among the circuits the protection afforded by the automatic stay.

2. THIS CASE PRESENTS AN IMPORTANT QUESTION REGARDING THE PROPRIETY OF A DISTRICT COURT RULING ON THE MERITS OF CLAIMS ASSERTED BY PARTIES NOT WITHIN ITS PERSONAL JURISDICTION IN AN ACTION PENDING IN ANOTHER JUDICIAL DISTRICT, WHICH CLAIMS CONSTITUTE DEFENSES TO A CAUSE OF ACTION PENDING BEFORE THE DISTRICT COURT.

As an initial matter, it must be emphasized that the fraud claims of the Bates shareholders, the Bond principals, do constitute defenses to the liability of NNIC, the surety, on the Bond. Succinctly stated, the fraud of the creditor upon the principal relieves the surety from liability on a bond. Restatement of Security §118 (1941); Rhode Island Hospital Trust National Bank v. Ohio Casualty Ins. Co., 789 F.2d 74, 78-80 (1st Cir. 1986). Unquestionably, the surety may assert fraud as a defense to a creditor's claim where the principal has elected to void the bond on the ground of

the creditor's fraud. Ettlinger v. National Surety Co., 221 N.Y. 467, 117 N.E. 945-46 (1917). (New York law applies here by stipulation in the Bond.) A surety who makes payment on a bond to a creditor despite knowledge of the principal's defenses against the creditor waives the right to obtain reimbursement from the principal. United States v. Griffin, 707 F.2d 1477, 1481 (D.C. Cir. 1983).

If any question ever existed on this point, the letter of Louis Bouchet, Jr., Mellon's Assistant Vice President, dispelled it. Bouchet on Mellon's behalf unequivocally acknowledged that NNIC was bonding the obligations of the Bates shareholders, the Bond principals, and not the obligations of Bates on the Note.

Although the district court recognized the import of Bouchet's admission, it nevertheless failed to proceed properly. Thereafter completely ignoring the limits of

personal jurisdiction and considerations of comity between district courts, the court proceeded to examine the merits of claims asserted by parties not within its jurisdiction, claims then pending in another judicial district. Finding such claims lacking the particularity required by Federal Rule of Civil Procedure 9(b), the district court then dismissed the relevance of those claims to NNIC's defense.

Compounding its error, the district court failed to handle the Rule 9(b) issue properly. Federal Rule of Civil Procedure 9(b) does require that fraud be pled with particularity. The remedy for failure to do so is not dismissal, however. Insufficient allegations of fraud are subject to the liberal amendment provisions of Federal Rule of Civil Procedure 15. 5 Wright & Miller, Federal Practice and Procedure (Civil) §1300, at 417 (1969). The policy of district courts in the Third Circuit permits

the pleader to amend to provide particularity rather than to merely dismiss. E.g., McClendon v. Continental Group, Inc., 602 F. Supp. 1492, 1509 (D. N.J. 1985); Chamber Development Co., Inc. v. Browning-Ferris Industries, 590 F. Supp. 1528, 1539 (W.D. Pa. 1984); Freedman v. Beneficial Corp., 406 F. Supp. 917, 925 (D. Del. 1975). The policy of the district courts in the Sixth Circuit, where the Ohio action is pending, is the same. E.g., Roger v. Lehman Bros. Kuhn Loeb, Inc., 604 F. Supp. 222, 225-26 (S.D. Ohio 1984).

Whatever its analysis of the Rule 9(b) issue, the district court should have respected the jurisdiction of the district court in the Ohio action and refrained from ruling on Mellon's summary judgment motion until the Ohio court adjudicated the fraud claims. More preferably, the district court should have transferred venue to the Northern District of Ohio where all the

parties asserting claims and defenses relating to the Bond could be joined. Despite these two available alternatives, the district court chose to act precipitously.

The decision of the circuit court in this case leaves NNIC in an untenable position, at risk of suffering inconsistent judgments. If the current judgment stands, NNIC, the surety on the Bond, must pay in full to Mellon, the creditor on the Bond, the amount of the outstanding principal and interest on the Limited Agreements of the Bates shareholders, the Bond principals. However, if those principals succeed in the Ohio action in having the Bond obligation voided, then NNIC will have no recourse for the payments made to Mellon. NNIC will have been forced by court order to pay a non-existent obligation. Throughout these proceedings, NNIC has asked merely for the determination of all claims and defenses regarding the

Bond in a single forum so that it will not be placed at risk in making a payment on the Bond that a later judgment may bar it from recovering from the principals. Black letter suretyship law fully supports NNIC's plea to avoid being placed in the middle between inconsistent judgments of two federal district courts.

The actions of the district court and the circuit court in this case raise the very important question of when a district court may make definitive rulings on claims asserted by parties not within its personal jurisdiction that nevertheless have relevance to a claim within its jurisdiction and by so ruling subject a party to the risk of inconsistent judgments. This Court should grant the writ to clarify the proper procedures in such cases, to preserve comity among the judicial districts in the federal court system, and to minimize the potential for inconsistent judgments.

CONCLUSION

For the foregoing reasons, a writ of certiorari should issue to review the judgment order of the United States Court of Appeals for the Third Circuit.

Respectfully submitted,

JOHN J. HARRIGAN,
Counsel of Record
ROBERT D. KEHOE
WILLIAM H. BAUGHMAN, JR.
WESTON, HURD, FALLON,
PAISLEY & HOWLEY
2500 Terminal Tower
Cleveland, Ohio 44113-2241
216/241-6602

Counsel for Petitioner

APPENDIX

JUDGMENT ORDER OF THE UNITED
STATES COURT OF APPEAL
FOR THE THIRD CIRCUIT
(Filed January 28, 1988)

UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT

No. 87-3563

MELLON BANK, N.A.

v.

NORTHWESTERN NATIONAL INSURANCE COMPANY
OF MILWAUKEE, WISCONSIN,

Appellant

On Appeal From the
United States District Court
for the Western District of Pennsylvania
(D.C. Civil No. 86-2033)
District Judge: Honorable Barron P. McCune

Argued January 20, 1988

Before: BECKER and SCIRICA, Circuit Judges
and HUYETT, District Judge*

JUDGMENT ORDER

After consideration of all contentions
raised by appellants, it is

ADJUDGED AND ORDERED that the judgment
of the district court be and is hereby
affirmed.

Costs taxed against appellant.

BY THE COURT,

/s/Edward R. Becker
Circuit Judge

ATTEST:

/s/Sally Mrvos, Clerk
Sally Mrvos, Clerk

DATED: JAN 28 1988

* Honorable Daniel H. Huyett, 3rd,
United States District Judge for the Eastern
District of Pennsylvania, sitting by
designation.

MEMORANDUM OF THE UNITED STATES
DISTRICT COURT
(Filed July 10, 1987)

IN THE UNITED STATES DISTRICT COURT
FOR THE WESTERN DISTRICT
OF PENNSYLVANIA

MELLON BANK, N.A.,	:
Plaintiff	:
	:
vs.	:Civil Action 86-2033
	:
NORTHWESTERN NATIONAL	:
INSURANCE COMPANY OF	:
MILWAUKEE, WISCONSIN,	:
Defendant	:

M E M O R A N D U M

BARRON P. McCUNE, Senior District Judge
July 11th, 1987.

We consider cross motions for summary judgment and the defendant's motion for reconsideration of our order of February 9, 1987, denying the defendant's motion for a transfer of venue to the Northern District of Ohio.

We will deny the motion for reconsideration and grant the plaintiff's motion

for summary judgment believing that there are no issues of material fact pending and that the defendant company is liable as a matter of law on the bond which it issued to protect Mellon in the event of default by Bates Energy Association, Inc.

The facts are not complicated. On December 16, 1983, Bates Energy Associates, Inc. (Bates), an Ohio corporation agreed to borrow and Mellon agreed to lend to Bates \$2,760,000.¹ On December 16, 1983, Bates executed a note and security agreement requiring repayment of the loan in 59 consecutive monthly installments. To induce Mellon to make the loan each of the stockholders of Bates signed a "Limited Guaranty and Suretyship Agreement" that guaranteed absolutely the obligation of Bates to the

¹ Bates was formed to furnish power to Bates College by burning wood in a steel boiler, apparently a less expensive source of power than the college had available.

extent of their respective investments in Bates. In addition on December 16, 1983, the defendant, Northwestern, executed a "Financial Guaranty Bond" which states that the individuals shown on schedule A to the bond (the same individuals who signed the guaranty) and Northwestern, a Wisconsin corporation, described as "Surety" are "held and firmly bound" unto Mellon in the principal sum of \$2,760,000 "together with interest for which payment we bind ourselves, our heirs, etc. by these presents." The condition of this obligation is that if the corporation (Bates) makes all of the payments of principal and interest and other sums in accordance with the note and security agreement, then this obligation shall be null and void, otherwise it shall remain in full force and effect.

The bond stated under "Definitions" that "default" shall mean failure by the corporation to make any payment under the

note in accordance with its term "(regardless of whether the corporation for any reason shall be under no legal obligation to discharge its obligations to the Bank under the note and security agreement)." This provision obviously was written with the possible bankruptcy of the corporation in mind.

The bond stated that it was irrevocable, absolute and continuing and "will remain in full force and effect until all sums due under the note and security agreement have been paid in full." (Underlining supplied).

Acceleration of the debt is mentioned in paragraph 5 under "Notice of Default." After a default a written notice to the surety is required no later than 60 days after the default. Notice shall include a signed statement stating the date payment was due, that the corporation is in default, "the aggregate amount due (whether by

acceleration or otherwise) as of the date of the statement, the amount representing interest accruing each day and the rate at which such amount is computed and that such aggregate amount due has not been paid." The paragraph continues that if the notice of default is not given, the bank waives only the installment for which notice was given. "Such failure shall not adversely affect or impair the bank's right to give notice of default and receive payment from the surety and surety's obligation to make payments to the bank with respect to any other installments due or the aggregate amount outstanding under the note and security agreement." (Underlining supplied).

Under paragraph 6 the surety waived all defenses either it or the principal might have, provided however, "that such waiver is not intended to absolve the bank from the bank's liability for any acts of wilful misconduct or gross negligence

related to the subject matter of this Bond."

Under paragraph 9 headed "Payment" the surety is obligated to pay the bank no later than 15 days after receipt of notice of default. Under paragraph 10 - "Surety's Continued Obligation" the surety agrees that its obligation continues whether the corporation is in bankruptcy or reorganization.

Under paragraph 13 - "Choice of Law"- it is agreed that the construction, validity and performance of the bond shall be governed by the laws of the State of New York and any applicable federal law.

The loan agreement and the guaranty and suretyship agreement and the financial guarantee bond were tightened up on April 12, 1985, when the interest rate was raised and the corporation (Bates) agreed not to pay dividends or make loans but nothing in the amendments detracted from the obligation

of the defendant which renewed its obligation on the bond on that date.

On November 25, 1985, Mellon gave notice to the defendant that the corporation (Bates) had failed to pay the October and November payments and demanded payment of principal and interest for those months in the amount of \$108,391.94. The defendant did not make the payment within 15 days.

On May 13, 1986, Mellon gave notice that Bates had failed to pay the monthly installments for December 1985 and for January through May of 1986. The bank demanded payment of the entire debt less the \$108,391.94 which the defendant had agreed to pay at noon on May 21, 1986. The amount demanded was \$2,936,259.95 less \$108,371.94 or \$2,827,868.01.

On May 7, 1986, Bates filed a petition in Bankruptcy under Chapter XI in the Northern District of Ohio.

On June 17, 1986, defendant made a payment to Mellon of \$451,587.87.

In its answer to the complaint defendant admits execution of the Financial Guarantee Bond and the payment of June 17, 1986, which it concedes was payment through May 1, 1986.

In a counterclaim the defendant avers that Mellon has made no demand since May of 1986 and has refused to satisfy a condition precedent to a demand on the defendant, the condition precedent being demand on the shareholders. It is also alleged that since Bates is in Bankruptcy, Mellon is prohibited by law from accelerating payments. Therefore defendant contends that it is only required to keep the note current. The counterclaim was duly answered. The payments have not been currently made and nothing has been paid since June 17, 1986.

The obligation of defendant is direct. It is not conditioned upon any demand being

All

made of the stockholders who signed the guarantee agreement or the bond. It is not conditioned upon the ability of Bates to pay anything. The defendant's obligation exists whether Bates is bankrupt or not. The bond specifically says this in plain words as pointed out above.

According to the affidavit of Louis C. Bonchat, Jr., Assistant Vice President of Mellon, the bank was asked to extend the time for receipt of the \$108,391.94 payment to the noon hour on May 21, 1986, and by letter of April 11, 1986, it granted the request and received in return an agreement (written on the bottom of the same letter) that the dates for demand for payment of the December, 1985 through March 1986 defaults were extended to May 21, 1986. The letter agreement is attached to the affidavit.

It appears that there is only one issue in dispute although the defendant seeks to raise others as will become

apparent later on.. The issue is whether payments may be accelerated. This depends on a reading of the bond. First, it is apparent that Bates' bankruptcy does not forbid acceleration. The bond clearly permits acceleration. Under paragraph 5, captioned "Notice of Default," it is stated that "Notice of default shall include a signed statement stating the date payment was due under the note and security agreement, that Bates is in default, (comma supplied) the aggregate amount due (whether by acceleration or otherwise) as of the date of the statement, the amount representing interest accruing each day and the rate at which such amount is computed and that such aggregate amount has not been paid."

The defendant is clearly responsible for the total amount of the debt. It has however attempted to delay payment.

In June of 1986 defendant (Northwestern) brought suit against the

shareholders of Bates on an indemnity agreement that if defendant was required to pay Mellon, then Bates and the shareholders of Bates were obliged to reimburse the defendant.² The suit was filed in the Northern District of Ohio, Eastern Division. After the filing of that suit the defendant attempted to have this action transferred. In an order dated February 9, 1987, we denied the motion to transfer. At that time we were not aware that the shareholders had filed an answer, a counterclaim and a third-party complaint in the Ohio action. The answer admitted the execution of the documents but attempted to rescind the obligation of the shareholders on the ground that applicable Ohio securities laws had been violated in the sale of Bates stock to the shareholders.

² Mellon was not a party to the indemnity agreement.

The third-party complaint named numerous parties including attorneys and accountants who had allegedly misinformed the shareholders about the details of the project for which Gates was formed, a plan to furnish energy to Bates College and it included Mellon. The claim against Mellon Bank is stated in the Sixth Claim. It is strained to say the least. It states that Mellon holds a securities interest in the boiler owned by Bates. The security interest was given as collateral for the \$2.76 million loan from Mellon to Bates. Rather than exercise its security interest in the boiler, Mellon has attempted to proceed directly against the shareholders as guarantors of the Bates loan, although any liability which they may have is secondary and Mellon has violated legal obligations toward the shareholders including the obligations of good faith and fair dealing and the duty to act with respect to

the collateral in a commercially reasonable manner.

Whatever worth these allegations have with respect to the obligations of the shareholders to pay Bates or Northwestern, they have nothing to do with Mellon's direct claim against the defendant, Northwestern, on its bond.

In the Ohio action Northwestern answered the counterclaim, denied that the violation of the securities laws, if any, barred its claim against the shareholders and asserted a cross claim against all of the third-party defendants in the Ohio action, including Mellon. In its claim against Mellon defendant Northwestern states that Mellon is first obligated to collect amounts due from Bates and the shareholders directly and to perfect a security interest in the property of Bates which it neglected to do so that Mellon may end up as an

unsecured creditor of Bates and be able to collect less than it would as a secured creditor, thus increasing Northwestern's obligation. It is alleged that Mellon's failures permit the crossclaim under paragraph 6 of the bond (paragraph 6 is set forth above).

Northwestern now argues that since Mellon is a party in the Ohio action we must reconsider our order and transfer this case to Ohio and that there are questions of fact now pending precluding judgment for Mellon. In fact Northwestern insists that we grant its own motion for summary judgment. But Northwestern has failed to point to a single provision of the bond which requires Mellon to perfect a security interest or collect directly from Bates or its shareholders. On the contrary, the obligation of Northwestern is direct and unconditional. We can determine no material fact in dispute and there is no reason to transfer the within

case to the Northern District of Ohio. The claims made there appear to be made for purposes of delay alone.

Northwestern also argues that since Bates is in bankruptcy the obligation on the bond cannot be accelerated. The law is clearly otherwise. The automatic stay provision of the code, 11 U.S.C. §362, does not protect a guarantor of the bankrupt's obligation, Lynch v. Johns-Manville Sales Corp, 710 F.2d 1194 (6th Cir. 1983); Austin v. Unarco Industries, Inc. 705 F.2d 1 (1st Cir. 1983); In re Magnus Harmonica Corp., 233 F. 802 (3d Cir. 1956).

An order follows.

/s/Barron P. McCune
BARRON P. MCCUNE
SENIOR UNITED STATES DISTRICT JUDGE

cc: Counsel of record

ORDER OF THE UNITED STATES
DISTRICT COURT
(Filed August 11, 1987)

IN THE UNITED STATES DISTRICT COURT
FOR THE WESTERN DISTRICT OF PENNSYLVANIA

MELLON BANK, N.A.,	:
Plaintiff	:
	:
vs.	:Civil Action 86-2033
	:
NORTHWESTERN NATIONAL	:
INSURANCE COMPANY OF	:
MILWAUKEE, WISCONSIN,	:
Defendant	:

O R D E R

AND NOW, August 7, 1987, the defendant's motion to vacate or alter or amend the judgment is denied.

/s/Barron P. McCune
BARRON P. McCUNE
SENIOR UNITED STATES DISTRICT JUDGE

cc: Craig W. Jones, Esq.
435 Sixth Avenue, Mellon Square
Pittsburgh, Pa. 15219

Robert D. Kehoe, Esq.
25th Floor Terminal Tower
Cleveland, Ohio 44113

MEMORANDUM OF THE UNITED STATES
DISTRICT COURT
(Filed August 11, 1988)

IN THE UNITED STATES DISTRICT COURT
FOR THE WESTERN DISTRICT OF PENNSYLVANIA

MELLON BANK, N.A.,	:
Plaintiff	:
	:
vs.	: Civil Action 86-2033
	:
NORTHWESTERN NATIONAL	:
INSURANCE COMPANY OF	:
MILWAUKEE, WISCONSIN,	:
Defendant	:

M E M O R A N D U M

BARRON P. McCUNE, Senior District Judge
August 10, 1987.

The defendant, Northwestern National Insurance Company of Milwaukee has filed a motion that the order of July 10, 1987, entered at the above number, be vacated and that judgment be entered for defendant or alternatively, that the case be tried.

The order of July 10, 1987, entered summary judgment for the plaintiff. The

opinion of the same date contains the facts and is incorporated by reference.

The motion to vacate adds only one new affidavit attaching a letter of an assistant vice-president of Mellon Bank dated April 11, 1985, stating that Northwestern is bonding the obligations of the several principals as defined in the bond and not the obligation of Bates Energy Associates, Inc.

This fact does not change our opinion of July 10, 1987. The several principals have defaulted just as the Bates Corporation has. The defendant repeats its argument that before it may become liable on its bond, the bank must have called upon the individual obligators to make payment. The bond does not state this to be so, and Northwestern has pointed to no provision supporting its argument. It did not take this position when it made the first payment

to Mellon on June 17, 1986, of \$451,587.87 for several months of defaulted payments.

The argument is repeated that the individuals who executed the bond have now charged in their Third Party Complaint in Ohio that fraud was practiced on them by many people including Mellon. The Third Party Complaint was examined and has been examined again. The only complaint directed at Mellon is paragraph 6 which alleges that Mellon failed to perfect a security interest in the equipment of Bates. The defendant's supplemental brief states "that pleading however contains other counts directed against all Third Party Defendants which group includes Mellon." We have searched that complaint for any allegation of fraud against Mellon and have found. none. Fraud must be pled with particularity. Specific facts must be alleged. A pleading which merely states that "we were defrauded" is not sufficient to state a cause of action.

Therefore, assuming that Mellon is somehow included in the group of third party defendants against whom the shareholders have made allegations in an attempt to escape liability, there is no specific charge of fraud against Mellon. Nor is it likely that such an allegation could be made in view of Rule 11. Mellon is the lender, not the borrower. It did not incorporate Bates. It did not sell the stock and it did not ask the shareholders to buy the stock.

We find nothing in the supplemental motion or brief which should change the order of July 10, 1987.

An order follows.

/s/Barron P. McCune

BARRON P. McCUNE
SENIOR UNITED STATES DISTRICT JUDGE

cc: Counsel of record

ORDER OF THE UNITED STATES
DISTRICT COURT
(Filed July 10, 1987)

IN THE UNITED STATES DISTRICT COURT
FOR THE WESTERN DISTRICT OF PENNSYLVANIA

MELLON BANK, N.A.,	:
Plaintiff	:
	:
vs.	:Civil Action 86-2033
	:
NORTHWESTERN NATIONAL	:
INSURANCE COMPANY OF	:
MILWAUKEE, WISCONSIN,	:
Defendant	:

O R D E R

AND NOW, July 10, 1987, the motion for reconsideration of our order refusing transfer of venue is denied. The motion of plaintiff for summary judgment is granted. The motion of defendant for summary judgment is denied. Judgment is entered for plaintiff and against defendant in the sum of \$2,484,672.08 together with interest to date and costs as set forth and provided by the Financial Guarantee Bond. The amount of the

judgment may be amended by further order based upon evidence of and costs and interest due.

/s/Barron P. McCune

BARRON P. McCUNE
SENIOR UNITED STATES DISTRICT JUDGE

cc: Craig W. Jones, Esq.
435 Sixth Avenue
Pittsburgh, Pa. 15219

Arthur Murphy, Jr., Esq.
326 Third Avenue
Pittsburgh, Pa. 15222

John Horrigan, Esq.
2500 Terminal Tower
Cleveland, Ohio 44113

JUDGMENT ORDER FOR THE UNITED STATES
COURT OF APPEALS FOR THE THIRD CIRCUIT
DENYING PETITION FOR REHEARING AND
SUGGESTION FOR REHEARING EN BANC
(Filed March 2, 1988)

UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT

No. 87-3563

MELLON BANK, N.A.

v.

NORTHWESTERN NATIONAL INSURANCE
COMPANY OF MILWAUKEE, WISCONSIN,

Appellant

SUR PETITION FOR REHEARING IN BANC

Present: GIBBONS, Chief Judge, SEITZ, WEIS,
SLOVITER, BECKER, STAPLETON, MANSMANN,
GREENBERG, HUTCHINSON, SCIRICA, COWEN,
Circuit Judges and HUYETT, District Judge*

* The Honorable Daniel H. Huyett, 3rd,
United States District Judge for the Eastern
District of Pennsylvania, sitting by
designation.

The petition for rehearing filed by appellant, Northwestern National Insurance Company, in the above-entitled case having been submitted to the judges who participated in the decision of this court and to all the other available circuit judges of the circuit in regular active service, and no judge who concurred in the decision having asked for rehearing, and a majority of the circuit judges of the circuit in regular active service not having voted for rehearing by the court in banc, the petition for rehearing is DENIED.

BY THE COURT:

/s/Edward R. Becker
Circuit Judge

DATED: March 2, 1988

